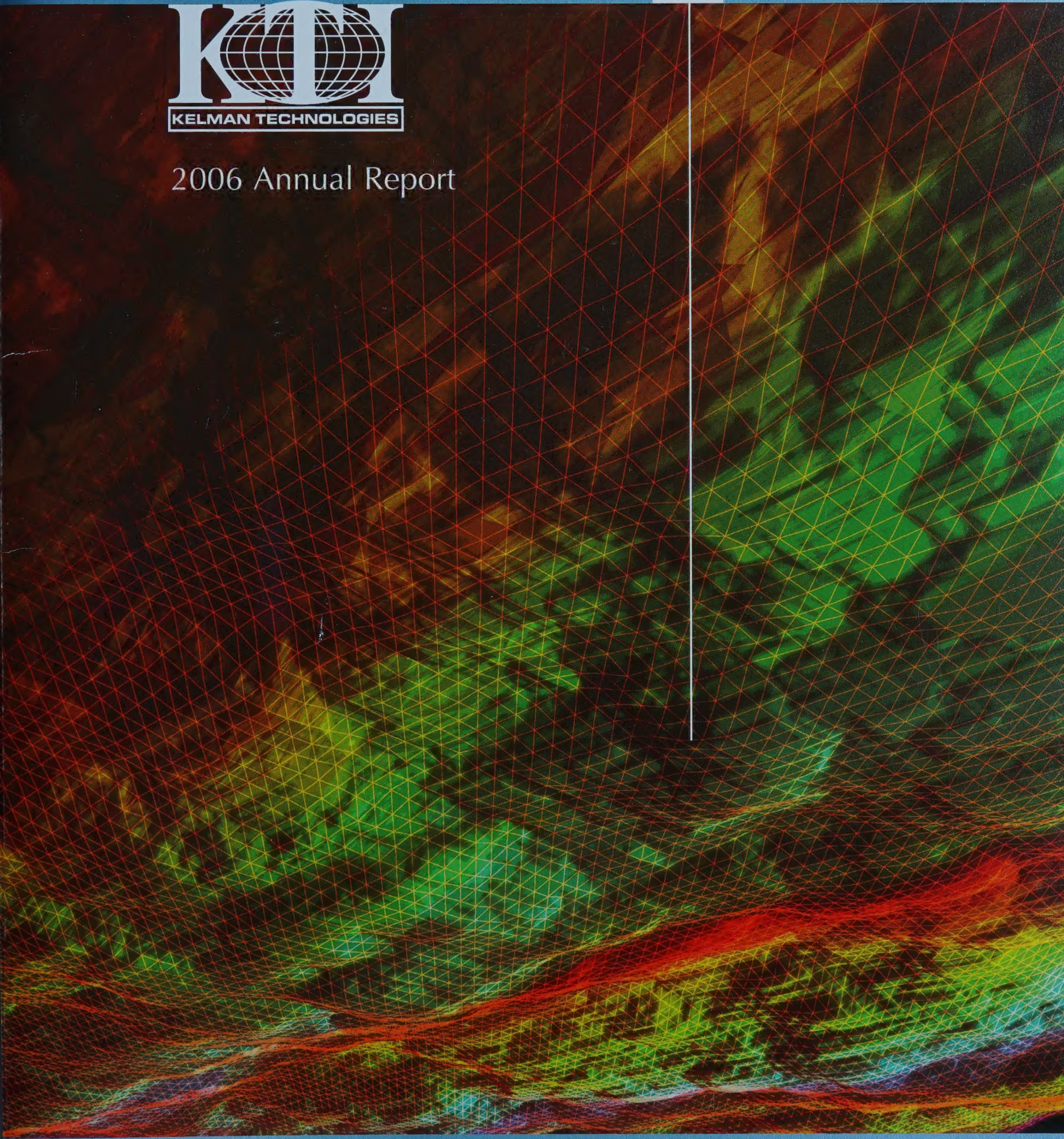
KELMAN TECHNOLOGIES

2006 Annual Report



Delivering Exceptional Services

EXCEPTIONAL PEOPLE, EXCEPTIONAL TECHNOLOGY – THE IMAGE YOU TRUST

Kelman Technologies Inc., is a publicly traded Canadian technology company with offices in Calgary and Toronto in Canada; Houston, Oklahoma City and Denver in the United States; London in the United Kingdom, and Tripoli in Libya, servicing client companies from 45 countries around the world with a full suite of technology solutions in seismic processing and on-line data archival and data management services. The Company's common shares trade on the Toronto Stock Exchange under the symbol "KTI".

CLIENT LOCATIONS

Highlights For The Year 2006

- Balance sheet healthy with no long term debt;
- US-based seismic data processing revenue increased 21% compared to 2005;
- Data management revenue increased 8% compared to 2005;
- Increased activity levels in US-based locations for both seismic data processing and data management divisions;
- Generated positive net income in 2006.

Letter to Shareholders

The results for 2006 reflect certain areas of improvement and others where continued work is necessary. On the positive side we have achieved continued growth in our US processing operations and in our data management business generally. Our success in US processing has been accomplished by the efforts of many individuals who have been instrumental in establishing the kind of high tech product the market demands. Equally important, new and standardized techniques, software improvements and a rigorous attention to the quality of the product we put into the hands of our clients has allowed Kelman to continue building a positive reputation for delivering consistent high quality products and services in the US market.

SEISMIC DATA PROCESSING

Canadian processing operations, traditionally our economic engine, has experienced a drop in revenues, arising through three main factors. First, the Calgary seismic processing market is very fractured with numerous small processing companies, including several new entrants to the market. This significant increase in competition in the market has limited the potential for any significant improvement in pricing for processing services. Second, the exploration industry in Canada has experienced dramatic increases in the commodity prices driving their businesses, which has caused them to rapidly expand their operations. Given the shortage of geophysicists in the market, many of the exploration companies have lured experienced and well-trained processing geophysicists from oil and gas service industry companies such as Kelman. While the Company has been successful in hiring a number of well-educated geophysicists, we have not been able to match the training and experience lost to our client companies. With improvements in our software and through standardized techniques we expect to move our new professionals quickly up the learning curve, but in the end we have lost experience which will take some time to recover. Third, in response to a dramatic increase in the cost of most oil and gas services coupled with a moderating price environment for natural gas, many customers began curtailing their activity levels in the last half of the year. While this is expected to be a temporary slowdown it did affect 2006 results and will impact early 2007 results from Canada.

International Processing operations has also experienced a slower than expected growth. Initial projects won by Kelman represented very difficult 2D data sets that have taken longer to complete than expected. We are in the process of reviewing our business model for the international marketplace.

DATA MANAGEMENT

Kelman's data management business refocused and positioned itself for aggressive growth in 2007. New technology offerings such as a map interface and internet delivery capability have earned acceptance from both current and prospective clients. Using this approach clients are now able to review where they hold data and order delivery of such data efficiently over the Internet. Kelman's Data Management business continues to hold the vast majority of the electronic seismic data management market in Canada and has plans for increased market penetration in 2007. US Data Management made significant improvements in 2006 and established even greater growth targets for 2007.

R. VandenBrand

Rene VandenBrand
President and CEO

Seismic Data Processing Division

Calgary

Work levels and revenues were basically on track for the first half of the year, but after a prolonged slowdown during the summer months, demand in the Calgary office never fully recovered. Revenues to the end of June 2006 had been up 20 percent relative to June 2005, but by year-end were down 12 percent from the prior year. This slowdown was precipitated by a number of factors: exploration and production companies had built up a large reserve of prospects from the increased explorations levels during the previous twelve months and commodity prices had dropped more than expected combined with a dramatic increase in the cost of most oil and gas services. In addition, the surprise announcement on October 31 that all Income Trusts were going to lose their tax preferred status in four years added to the uncertainty.

USA

In the US offices, demand for processing services was up for the entire year resulting in revenue growth in all three centers. Oklahoma City showed the largest increase at 44 percent over 2005, while Denver and Houston had increases of 14 percent and 13 percent, respectively. The industry in the US continues to operate at the highest level in years with numerous new 3D projects being acquired throughout the continental US. In addition, many of the majors have begun to refocus their resources on developing their land assets. This in turn has resulted in a proportionally greater increase in land processing services required. This has benefited the Company, which has traditionally excelled in complex land processing and has a reputation as an outstanding land seismic data processing company. We expect 2007 to continue to be a strong year for the US market.

International

During fiscal 2006 KT International maintained a small two-man operation in London and grew the office in Tripoli to include one Libya Country Manager, two Canadian ex-pats and two local processing professionals plus support staff. We also added a small Linux PC cluster along with the workstation capabilities to support some on-site processing capability for the local staff.

During 2006 the London office won significant bids from Algeria, Madagascar, and Tanzania. We believe that exploration activity for natural gas in Algeria will expand greatly over the next five years. Several of their onshore basins are relatively under explored and

the potential for identifying new gas reserves is significant. Also, the European Union is now more motivated to identify alternative sources for natural gas and the infrastructure connecting Algeria to Europe is already in place. A project from the North Sea was completed in 2006 that utilized the Company's proprietary patented technology called Stretch-Free Stacking. Recently, several Canadian companies have acquired exploration blocks in the North Sea and we hope to build on this niche technology offering.

During 2006, the Company found that the remote-processing model to support a small Tripoli office is not as efficient as hoped. The National Oil Company (NOC) is applying increasing pressure to process the data locally. We are currently reviewing our strategy with respect to this market and may consider pulling back from this market.

Data Management Division

Calgary

The Canadian Market rebounded from an extremely slow second and third quarter with a strong fourth quarter. Overall revenues for 2006 were flat as compared to 2005 and can be attributed to two major projects originally scheduled to start in the second quarter being delayed to the fourth quarter of 2006 and the first quarter of 2007. Industry activity has remained steady through the end of the year. With efficiencies gained through the course of the year, we have taken the opportunity to reorganize and keep costs in line with activity levels.

Our development efforts continued with the roll out of internet connectivity that enables our clients to view their inventory of data, add value by utilizing full edit capabilities, and request electronic data delivery in a highly secure fashion. This roll out, in combination with a front-end map interface, was extremely well received. Many of our major clients are in the process of adopting these changes. The interface now gives our clients the ability to geographically select their data and receive detailed reports along with the ability to request the data for delivery or for sale.

We are expecting significant growth in 2007. We have reorganized our business in Calgary to create a greater focus on sales and our overall strategic approach to the market. The digital storage and maintenance revenue continues to grow and now represents about one third of our overall data management revenues. This is a very positive sign as this represents our recurring monthly revenue, and reinforces the success of our overall business model.

USA

The US Data Management Division had a strong third and forth quarter resulting in an overall revenue increase of 43 percent over the previous year. The increase was based on the signing of two new oil and gas clients and an increase from our existing clients. Our new map interface that allows customers to search and order their data geographically, has been extremely well received. We were also able to sign a major data management contract in December that will create a strong start to 2007. With a new management team in Houston we are looking forward to continued growth in this market.

Outlook

With commodity prices retreating from their highs, exploration activity is expected to show some erosion from 2006 levels, primarily in our Canadian market for seismic processing services. Overall, we expect the US market to be strong for both our processing and data management businesses.

In the end, the Company's success will be dependent upon matching investing activities for future growth with our ability to fund such investments. Our plan for 2007 is to continue to focus on the basic economics of our business – developing exceptional technology that helps our customers reduce risk and find new reserves.

Management's Discussion And Analysis

The following Management's Discussion and Analysis has been prepared taking into consideration information available to March 7, 2007, and is supplemental to the consolidated financial statements and related notes contained in this annual report for the year ended December 31, 2006. The discussion and analysis of the financial condition and results of operations has been prepared by management and should be read in conjunction with the accompanying consolidated financial statements and related notes. All amounts in this discussion are expressed in Canadian dollars.

The Company uses the terms "EBITDA" and "funds from operations" throughout this report to analyze corporate performance both historically and on an on-going basis. EBITDA and funds from operations, are not recognized measures under Canadian generally accepted accounting principles ("GAAP") but management believes the use of the terms, "EBITDA" and "funds from operations" is consistent with industry practice but the method used to calculate may not be comparable. The Company's definition of EBITDA is net earnings before interest, taxes, depreciation and amortization and foreign exchange. The Company's definition of funds from operations is net earnings plus the following: depreciation and amortization, stock-based compensation expense, accretion of preferred shares, amortization of other assets, lease inducement benefit, loss on disposal of property and equipment, and future income taxes, plus an unrealized foreign exchange loss or less an unrealized foreign exchange gain. The Company's definition of funds from operations excludes the impact of changes in non-cash working capital.

SELECTED ANNUAL INFORMATION

(000s, except per share amounts)	**2006**	2005	2004
Revenue	**$ 25,911**	$ 23,865	$ 21,042
Net earnings (loss)	**$ 239**	$ (2,817)	$ (2,099)
Per share (basic and diluted)	**$ 0.01**	$ (0.07)	$ (0.05)
Cash dividends declared			
Series A Preferred Shares	**$ –**	$ –	$ 284
Series B Preferred Shares	**$ 272**	$ 272	$ 42
Series C Preferred Shares	**$ 72**	$ 37	$ –
Total assets	**$ 15,493**	$ 15,734	$ 16,003
Total debt	**$ –**	$ 6	$ 47

Activity levels improved significantly in the last quarter of 2006 in the US-based Seismic Data Processing locations and the overall Data Management Division. Year over year revenues for seismic data processing increased 9 percent and seismic data management revenues increased 8 percent, mainly as a result of higher activity levels in the US-based locations for both divisions of the Company.

In the fourth quarter of 2006, the Company wrote-off the net book value of computer hardware assets that were taken out-of-service. This amount totaled $121 thousand and has been included in depreciation and amortization expense.

OVERVIEW OF OPERATING RESULTS

(000s, except per share amounts)	2006	2005	Change
Net earnings (loss)	$ 239	$ (2,817)	N/A
Per share (basic and diluted)	$ 0.01	$ (0.07)	N/A
Funds from operations	$ 3,761	$ 3,631	4%
Weighted average number of shares outstanding (diluted)	40,326	39,570	

The net earnings of $239 thousand in 2006 is, as previously mentioned, attributable to increased activity levels in the fourth quarter of 2006 in the US-based locations for both the Seismic Data Processing and Data Management Divisions. Late in 2006, activity levels decreased significantly in the Calgary-based location of the seismic data processing division. The reduced activity levels were the result of a number of factors: exploration and production companies had built up a large reserve of prospects from the increased explorations levels during the previous twelve months, commodity prices had dropped more than expected, and at the same time they experienced a dramatic increase in the cost of most oil and gas services. In addition, the surprise announcement from the Canadian government on October 31 that all Income Trusts were going to lose their tax preferred status in four years added to the uncertainty.

Funds from operations for the year ended December 31, 2006 were $3.8 million, an increase of $130 thousand from $3.6 million generated in 2005. Per share earnings (basic and diluted) for the year ended December 31, 2006 was $0.01 compared to per share loss of $0.07 in 2005. Per share figures are based on the weighted average shares outstanding of 40,326,275 (diluted) during the year ended December 31, 2005 compared to 39,570,284 (diluted) in 2005.

Earnings for the quarter ended December 31, 2006 were $355 thousand prior to the write-off of $121 thousand for computer hardware.

Funds from operations for the quarter ended December 31, 2006, were $1.2 million, a decrease of $863 thousand from the comparable period in 2005. Per share earnings (basic and diluted) in the fourth quarter of 2006 was $0.01 compared to $0.00 in the comparable period in 2005. Per share figures are based on the weighted average shares outstanding of 40,844,617 (diluted) during the fourth quarter of 2006 compared to 39,579,987 (diluted) during the comparable period in 2005.

OPERATING REVENUE

(000s)	2006	2005	Change
Seismic Data Processing			
Canada	$ 10,316	$ 10,685	(3)%
All Other	9,012	7,098	27%
	$ 19,328	$ 17,783	9%
Seismic Data Management			
Canada	$ 5,363	$ 5,231	3%
All Other	1,220	851	43%
	$ 6,583	$ 6,082	8%
	$ 25,911	$ 23,865	9%

Seismic data processing revenue for the year ended December 31, 2006 of $19.3 million increased 9 percent from $17.8 million in 2005, as a result of increased activity levels in the US-based locations. US-based seismic data processing revenue of $8.5 million increased 21 percent from revenue of $7.1 million in 2005. Foreign-sourced revenue of $12.8 million represents 50 percent of total seismic data processing revenue for the year ended December 31, 2006, a significant increase from $9.7 million representing 55 percent of total seismic data processing revenue in 2005.

In the year ended December 31, 2006, data management revenue of $6.6 million increased 8 percent as a result of higher activity levels in the US-based location in the latter part of 2006 compared to $6.1 million in 2005. The Company expects activity levels to increase significantly in 2007 in the US market.

Seismic data processing revenue for the quarter ended December 31, 2006 of $4.8 million decreased 16 percent from $5.7 million for the comparable period in 2005, as a result of significantly decreased sales and activity levels in the Canadian market which led to a 45 percent decrease in revenue for the quarter for this location compared to the comparable quarter in 2005. Foreign-sourced revenue of $3.4 million represents 51 percent of total seismic data processing revenue for the fourth quarter, a slight increase from $3.0 million or 54 percent for the comparable period in 2005. The order backlog for seismic data processing services at December 31, 2006 was $4.4 million, down significantly from $5.7 million in the comparable period in 2005.

In the quarter ended December 31, 2006, data management revenue of $1.9 million increased 3 percent from the comparable period in 2005. The order backlog for data management services was $2.9 million, up from $2.4 million in the comparable period in 2005.

OPERATING EXPENSES

(000s)	**2006**	2005	Change
Operating expenses	**$ 21,958**	$ 20,077	9%

In the year ended December 31, 2006, Seismic Data Processing Division operating expenses were $16.6 million, a 9 percent increase from $15.3 million in 2005. The increase in operating expenses is mainly attributed to international expansion, salary increases, higher occupancy and maintenance costs in the year.

In the year ended December 31, 2006 Data Management Division operating expenses were $5.3 million, a 10 percent increase from $4.8 million in 2005. The increase in operating expenses is mainly attributed to staff increases in the US-based location with a focus on sales efforts. The focused sales efforts led to higher activity levels, particularly in the latter part of 2006.

In the quarter ended December 31, 2006, Seismic Data Processing Division operating expenses were $4.2 million, a 1 percent decrease from $4.3 million in the comparable period in 2005.

In the quarter ended December 31, 2006, Data Management Division operating expenses were $1.4 million, a 13 percent increase from $1.2 million in the comparable period in 2005. The increase in operating expenses is mainly attributed to costs associated with the focused sales efforts and increased activity levels in the US-based location.

DEPRECIATION AND AMORTIZATION

(000s)	**2006**	2005	Change
Depreciation and amortization	**$ 3,190**	$ 4,196	24%

Depreciation and amortization expense for the year ended December 31, 2006 was lower than the year ended December 31, 2005 mainly as a result of the write-off taken in the fourth quarter of 2005 for obsolete

and out-of-service computer hardware with a net book value of $1.2 million. Capital expenditures in the year were $2.6 million, down 5 percent from $2.8 million in 2005.

The Company changed the service life of its computer hardware purchased prior to July 1, 2005 for the purposes of determining depreciation expense. The depreciation rate on computer hardware expenditures purchased and in service prior to July 1, 2005 was changed from 25 percent declining-balance to 35 percent declining-balance. This change in accounting estimate has been applied prospectively and resulted in an increase of $253,714 in depreciation expense for the year ended December 31, 2006. The depreciation rate on computer hardware expenditures purchased and in service after July 1, 2005 is 3 years straight-line.

In the quarter ended December 31, 2006, depreciation and amortization expense was $898 thousand including the write-off of obsolete and out-of-service computer hardware with a net book value of $121 thousand, a significant decrease from $2.0 million in the comparable period in 2005, which included the write-off of obsolete and out-of-service computer hardware with a net book value of $1.2 million. Capital expenditures in the quarter were $579 thousand, down significantly from $1.0 million in the comparable period in 2005.

INTEREST AND DIVIDENDS

(000s)	**2006**	2005	Change
Interest on short-term debt	**$ 87**	$ 136	(36)%
Interest on long-term debt	**–**	2	N/A
Preferred share dividends	**345**	309	12%
Accretion of preferred shares	**162**	145	12%
Total interest and dividends	**$ 594**	$ 592	–

Interest on short-term debt decreased as a result of lower short-term debt outstanding during the year. Most of the interest expense in the current year is related to dividends on the Company's class B and class C Preferred Shares plus the accretion of the debt component of the aforementioned Preferred Shares over the term of the Preferred Shares. Given that the Preferred Shares are subject to prescribed redemption, accounting rules dictate that dividends thereon are classified as interest expense.

The Company has an unrecognized net future income tax asset totaling $13.0 million. This asset can be used to reduce taxable income in the next several years. The US Company has US $14.7 million in net operating losses expiring at various times until 2025.

In the second quarter of 2005, as a result of continuing losses, the Company increased the valuation allowance to reduce the carrying value of the future tax asset to $ nil. This resulted in a non-cash charge of $1.8 million that increased the net loss to $2.8 million for the year ended December 31, 2005. All of the components comprising the future tax asset continue to be available to the Company to reduce income taxes on future earnings.

WORKING CAPITAL AND CASH BALANCES

(000s)	2006	2005	Change
Working capital before preferred shares	**$ 7,856**	$ 6,129	28%
Preferred shares (included as a current liability)	**$ (605)**	$ (605)	N/A
Working capital	**$ 7,251**	$ 5,524	31%
Cash position (after indebtedness)	**$ 1,558**	$ 851	83%

Cash continued to be directed primarily to international expansion activities and capital additions during the year ended December 31, 2006.

Capital expenditures in the year ended December 31, 2006 were $2.6 million, a decrease of 5 percent from $2.8 million in 2005.

Capital expenditures in the quarter ended December 31, 2006 were $579 thousand, a decrease of 42 percent from $1.0 million in the comparable period in 2005.

LIQUIDITY AND CAPITAL RESOURCES

In the quarter and the year ended December 31, 2006, there were no additions to term debt. The Company had no term debt as at December 31, 2006.

The Company has a demand loan with Video Age Limited, a company controlled by Seymour Epstein, Chairman of the Board and a major shareholder of the Company, in the amount of $487,500 with an annual interest rate of 7.75 percent, which is consistent with prevailing commercial terms. The Company uses this demand loan for general corporate purposes.

In 2006, the balance owing on the demand loan was reduced to $487,500 from $1,000,000 when 1,250,000 warrants issued in June of 2001 to Seyco Operations Ltd., another company controlled by Mr. Epstein, were exercised at a price of $0.41 each. The total funds received by the Company were used to reduce the balance on the demand loan.

The Company expects to fund capital expenditures and expansion in 2007 through normal cash flow and its demand loan with Video Age Limited.

In 2005, the Company completed an offer, with approval by the Toronto Stock Exchange, to participating members of senior management of the Company for a class of Series C Convertible Preferred Shares. The shares are redeemable at the close of business on the next business day following the fifth anniversary of the date of issue. The shares are priced at $0.30 each and will be convertible, at the option of the holder into one common share at any time prior to expiry. The shares carry a dividend rate of 7.25 percent. The dividends are cumulative. 3,333,333 shares were issued for proceeds of $1,000,000. Preferred shares are recorded at the amount of proceeds received less the amount attributed to the conversion feature of $170,887 which is included as part of shareholders' equity.

The Company, with agreement from all of the Preferred Shareholders affected, issued demand promissory notes for the dividends that were accrued but not paid on September 30, 2005 and December 31, 2005. The total amount of the promissory notes issued was $168,332. Interest on the demand promissory notes is payable quarterly at a rate of 7.25 percent per annum, with interest on overdue amounts at the same rate. On January 24, 2006 the promissory notes were repaid in full.

OFF-BALANCE SHEET ARRANGEMENTS

The Company has no investments in any off-balance sheet ventures such as partnerships or joint ventures.

RELATED PARTY TRANSACTIONS

The majority of the Series B and Series C Convertible Preferred Shares are held by a company related to the Company's major shareholder and a director, another director, and three officers of the Company. Dividends paid in this regard for the Series B and Series C Convertible Preferred Shares in 2006 were $501,340 (2005 - $129,636).

CHANGES IN ACCOUNTING POLICIES

There have been no changes in accounting policies, which affect the December 31, 2006 consolidated financial statements.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with Canadian generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of these annual financial statements and the reported amounts of revenue and expenses during the reporting period.

The Company's services are generally sold based upon purchase orders or contracts with the customer that include fixed or determinable prices based upon unit rates. Customer contract terms do not include provisions for significant post-service delivery obligations. Revenue is recognized when services are rendered based upon achieving certain measurable stages of customer projects and only when collectibility is reasonably assured.

Depreciation expense is recorded using the declining-balance and the straight-line methods and is based upon allocating the cost of property and equipment less salvage value (if any) over the estimated service life, which may differ from physical life. Effective January 1, 2006 the Company changed the useful life of its computer hardware for the purposes of determining depreciation expense. The depreciation rate on computer hardware expenditures purchased and in service prior to July 1, 2005 was changed from 25 percent declining balance to 35 percent declining balance. This change in accounting estimate was applied prospectively.

CONTRACTUAL OBLIGATIONS

Future minimum payments relating to operating leases are as follows:

2007	$ 1,601,268
2008	1,423,471
2009	1,393,988
2010	1,322,106
2011	–

The majority of the future minimum payments relating to operating leases is for office space. In addition, the Company has operating leases for office equipment and computer hardware, both of which will expire in 2007.

FINANCIAL INSTRUMENTS

The Canadian Institute of Chartered Accountants issued new pronouncements for accounting of Financial Instruments and Comprehensive Income that were applicable for the year ending after December 31, 2006. The Company's financial instruments include cash, accounts receivable, accounts payable and accrued liabilities, and preferred shares that bear market rates of interest. The Company believes that the carrying values of the

financial instruments closely approximate their fair values, therefore, there was no impact from the adoption of the recommendations of these pronouncements nor does the Company foresee any significant impact in the future.

The Company's revenue is largely derived from well-established customers such that credit risk is not considered significant. The Company is exposed to foreign currency fluctuations in respect of its operations in the United States, United Kingdom, and Libya.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure. The Company's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by the annual filings, that the Company's disclosure controls and procedures as of the end of such period are effective to provide reasonable assurance that material information related to the Company, including its consolidated subsidiaries, is made known to them by others within those entities. It should be noted that while the Company's Chief Executive Officer and Chief Financial Officer believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

INTERNAL CONTROL RISKS

The Chief Executive Officer and Chief Financial Officer of the Company are responsible for designing internal controls over financial reporting or causing them to be designed under supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles. The design of the Company's internal control over financial reporting was assessed as of the date of this Management's Discussion and Analysis. The weaknesses in the Company's internal controls over financial reporting, discussed below, result in a more than remote likelihood that a material misstatement would not be prevented or detected. Management and the Board of Directors work to mitigate the risk of a material misstatement in financial reporting, however, there can be no assurance that this risk can be reduced to less than a remote likelihood of a material misstatement.

SEGREGATION OF DUTIES

Control deficiencies have been identified within the Company's foreign branch locations in the United Kingdom and Tripoli, Libya and the Company's accounting and finance department and its financial information systems over segregation of duties and user access, respectively. First, the Company identified instances whereby personnel had the ability to initiate and approve transactions for their respective branch locations due to the small number of individuals employed in these branch locations. Second, certain duties within the accounting and finance department were also not properly segregated due to the small number of individuals employed in these areas. Third, the Company identified instances whereby personnel have the ability to initiate transactions or accounting entries within certain financial reporting applications that are not compatible with their other roles and responsibilities. None of the segregation of duty or access control deficiencies has resulted in a misstatement to the financial statements. However, these deficiencies may be considered a material weakness resulting in a more-than remote likelihood that a material misstatement of the Company's annual or interim financial statements would not be prevented or detected. As the Company incurs future growth, we

plan to expand the number of individuals involved in those functions. At the present time, the Chief Executive Officer and the Chief Financial Officer oversee all material transactions and related accounting records. The Audit Committee reviews on a quarterly basis the financial statements and key risks of the Company and queries management about significant transactions. In addition, there is daily oversight by the senior management of the Company.

CAPITAL SUMMARY

The following table provides details of the Company's issued and outstanding shares for the periods ended December 31, 2006 and December 31, 2005.

	December 31, 2006	December 31, 2005
Weighted average shares outstanding:		
Basic and diluted	**40,326,275**	39,570,284
Shares outstanding at year end	**41,635,206**	40,373,441

At December 31, 2006 there were 2,305,000 (2005 – 1,604,654) stock options outstanding at exercise prices ranging from $0.40 to $0.64 (2005 - $0.27 to $0.65).

At March 7, 2006 there were 41,635,206 Common Shares, 2,260,00 stock options and 1,455,000 phantom options outstanding.

FINANCIAL SUMMARY OF QUARTERLY RESULTS

($000s Except Per Share Data)

	2006				2005			
	Q4	**Q3**	**Q2**	**Q1**	Q4	Q3	Q2	Q1
Seismic data processing revenue	**4,775**	**4,556**	**5,277**	**4,720**	5,666	4,395	4,158	3,564
Seismic data management revenue	**1,905**	**1,428**	**1,512**	**1,738**	1,847	1,476	1,391	1,368
Total revenue	**6,680**	**5,984**	**6,789**	**6,458**	7,513	5,871	5,549	4,932
Net earnings (loss)	**234**	**(278)**	**182**	**101**	(97)	(47)	(2,127)	(546)
Per share (basic and diluted)	**0.01**	**(0.01)**	**0.00**	**0.00**	(0.00)	(0.00)	(0.05)	(0.01)

In the fourth quarter of 2006, data management revenues increased 33 percent over the third quarter as a result of significantly higher revenues in the US-based location resulting from increased sales efforts which led to higher activity levels, as previously mentioned. Sales efforts in this division will continue to focus on the US data management market plus there will be a focused sales effort on the Canadian data management market to attract new customers. In the fourth quarter of 2006 seismic data processing revenues for the US-based locations increased 23 percent over the third quarter as a result of increased sales efforts which led to higher activity levels, as previously mentioned. The Canadian based seismic data processing market saw a drop off in activity levels in the latter part of 2006, as previously mentioned in the Overview of Operating Results.

In the fourth quarter of 2005, seismic data processing revenues increased 29 percent over the third quarter as a result of significantly higher revenues in all of the processing locations. A small positive net income of $233 thousand was changed to a loss as a result of the write-off of $1.2 million for obsolete and out-of-service computer hardware that was recognized at December 31, 2005. In the third quarter of 2005, seismic data

processing revenues increased 6 percent when revenue rebounded in the second month of the quarter in the Canadian based operation when activity levels picked up. The overall market in the first quarter was at a virtual standstill and was also very price-competitive. In the fourth quarter, data management revenues increased substantially.

RISKS AND UNCERTAINTIES

The Company is engaged in seismic data processing and data management. The demand for these services is somewhat dependent upon the level of expenditures in the exploration and production segment of the oil and gas industry. These expenditures are influenced primarily by the price of the commodity being produced. The Company is also subject to risk and uncertainty related to technological advances and direct competition within the data processing and data archival sectors.

With a continued commitment to product enhancement and value-added customer service, the Company attempts to minimize risk in the seismic data processing realm by offering a sophisticated suite of proprietary products and applications in land and marine processing to customers located in countries around the world.

The Company's state of the art data management line of business is not as directly affected by fluctuations in exploration activity. A flexible open system to meet client's specific needs provides an economical solution to data storage, retrieval and management and as such is less dependent on capital exploration budgets. The Company has created residual revenues through long-term working relationships with clients, which helps to minimize short-term volatility in the market.

FORWARD-LOOKING STATEMENTS

In addition to historical information, this report contains statements which by their nature are forward-looking and which involve known and unknown risks, delays, uncertainties and other factors not under the Company's control. Any of these factors may cause actual results, performance or achievement to be materially different from the results, performance or expectation implied by these forward-looking statements.

Other information about the Company can be found on SEDAR or on the Company's website: www.kelman.com.

Management's Report

The accompanying consolidated financial statements of Kelman Technologies Inc. and all information in the annual report were prepared by and are the responsibility of management. The consolidated financial statements have been prepared in accordance with accounting policies outlined in the notes to the consolidated financial statements and in conformity with Canadian generally accepted accounting principles.

Management maintains appropriate systems of internal controls designed to provide reasonable assurance that all transactions are appropriately authorized, assets are safeguarded, and financial records are properly maintained to provide reliable information for the preparation of the financial statements.

The consolidated financial statements have been examined in accordance with generally accepted auditing standards in Canada by the independent accounting firm KPMG LLP whose appointment is ratified annually by the shareholders at the annual shareholders' meeting.

The Audit Committee of the Board of Directors, which is comprised exclusively of directors who are not employees of the Company, has reviewed the consolidated financial statements, including the notes thereto, with management and KPMG. The Board of Directors approved the consolidated financial statements on the recommendation of the Audit Committee.

Rene VandenBrand
President and CEO

Seymour Epstein
Chairman

Debbie Garbutt, CFO
March 7, 2007

Auditors' Report to the Shareholders

We have audited the consolidated balance sheets of Kelman Technologies Inc. as at December 31, 2006 and 2005 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP
Chartered Accountants
Calgary, Canada
March 7, 2007

Consolidated Balance Sheets

December 31, 2006 and 2005	2006	2005
ASSETS		
Current assets:		
Cash	**$ 2,045,785**	$ 1,851,476
Accounts receivable	**5,406,905**	5,348,804
Work in progress	**2,081,447**	2,026,388
Prepaid expenses and deposits	**423,566**	399,657
	9,957,703	9,626,325
Property and equipment *(note 3)*	**5,517,916**	6,084,582
Other assets *(note 4)*	**17,081**	22,775
	15,492,700	15,733,682
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Indebtedness *(note 6)*	**$ 487,500**	$ 1,000,000
Accounts payable and accrued liabilities	**1,613,736**	2,239,071
Deferred revenue	**–**	252,609
Current portion of capital lease	**–**	5,779
Preferred shares *(note 7)*	**605,321**	605,321
	2,706,557	4,102,780
Preferred shares *(note 7)*	**3,645,774**	3,483,233
Shareholders' equity:		
Share capital *(note 8)*	**13,125,325**	12,609,980
Equity component of preferred shares *(note 7)*	**812,706**	812,706
Contributed surplus *(note 8)*	**799,512**	561,314
Deficit	**(5,597,174)**	(5,836,331)
	9,140,369	8,147,669
Commitments *(note 9)*		
	$ 15,492,700	$ 15,733,682

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Rene VandenBrand
Director

Seymour Epstein
Director

Consolidated Statements of Operations and Deficit

Years ended December 31, 2006 and 2005	**2006**	2005
Revenue	**$ 25,911,148**	$ 23,865,037
Expenses:		
Operating	**21,958,083**	20,077,053
Depreciation and amortization *(note 3)*	**3,189,706**	4,196,465
Interest	**594,424**	591,875
Foreign exchange gain (loss)	**(70,222)**	16,945
	25,671,991	24,882,338
Earnings (loss) before income taxes	**239,157**	(1,017,301)
Future income tax *(note 5)*	**–**	(1,800,000)
Net earnings (loss)	**$ 239,157**	$ (2,817,301)
Deficit, beginning of year	**$ (5,836,331)**	$ (3,019,030)
Deficit, end of year	**$ (5,597,174)**	$ (5,836,331)
Net earnings (loss) per Common Share, basic and diluted *(note 8)*	**$ 0.01**	$ (0.07)

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years ended December 31, 2006 and 2005	2006	2005
Cash provided by (used in):		
Operations:		
Net earnings (loss)	**$ 239,157**	$ (2,817,301)
Items not involving cash:		
Depreciation and amortization	**3,189,706**	4,196,465
Stock-based compensation expense	**241,043**	145,645
Accretion of preferred shares	**162,541**	145,452
Amortization of other assets	**5,694**	33,628
Lease inducement benefit	**3,313**	101,574
Loss on disposal of property and equipment	**3,090**	2,025
Future income taxes	**–**	1,800,000
Unrealized foreign exchange gain (loss)	**(84,026)**	23,549
	3,760,518	3,631,037
Change in non-cash working capital items	**(965,813)**	(1,517,107)
	2,794,705	2,113,930
Financing:		
Issue of common shares	**512,500**	–
Issue of preferred shares	**–**	1,000,000
Repayment of capital lease	**(5,779)**	(40,829)
Increase (decrease) in indebtedness	**(512,500)**	500,000
	(5,779)	1,459,171
Investing:		
Expenditures on property and equipment	**(2,626,130)**	(2,766,490)
Change in non-cash working capital items	**31,513**	314,429
	(2,594,617)	(2,452,061)
Increase in cash	**194,309**	1,121,040
Cash, beginning of year	**1,851,476**	730,436
Cash, end of year	**$ 2,045,785**	$ 1,851,476
Supplemental information:		
Interest paid	**$ 596,349**	$ 273,810
Interest received	**$ 286**	$ 240

See accompanying notes to consolidated financial statements.

SIGNIFICANT ACCOUNTING POLICIES:

(a) Basis of presentation:

These financial statements include the accounts of the Company and those of its subsidiaries, all of which are wholly owned.

(b) Use of estimates and assumptions:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

(c) Foreign currency translation:

The Company's subsidiaries are accounted for as integrated foreign operations. Foreign-denominated monetary assets and liabilities are translated at the exchange rate prevailing at the balance sheet date. Revenue and expenses, other than depreciation and amortization, are translated at average rates of exchange during the period. Non-monetary assets and liabilities are translated at the exchange rate in effect at the date of the transaction. Exchange gains and losses arising on the translation of monetary assets and liabilities are recorded in the statement of operations.

(d) Revenue recognition:

The Company's services are generally sold based upon purchase orders or contracts with the customer that include fixed or determinable prices based upon unit rates. Customer contract terms do not include provisions for significant post-service delivery obligations. Revenue is recognized when services are rendered based upon achieving certain measurable stages of customer projects and only when collectibility is reasonably assured.

rty and equipment:

Computer hardware – acquired up to June 30, 2005	35% declining-balance
Computer hardware – acquired after June 30, 2005	3 years straight-line
Computer software	3 years straight-line
Equipment and furniture	5 years straight-line
Leasehold improvements	5 years straight-line

The Company changed the service life of its computer hardware purchased prior to July 1, 2005 for the purposes of determining depreciation expense. The depreciation rate on computer hardware expenditures purchased and in service prior to July 1, 2005 was changed from 25 percent declining-balance to 35 percent declining-balance. This change in accounting estimate has been applied prospectively and resulted in an increase of $253,714 in depreciation expense for the year ended December 31, 2006. The depreciation rate on computer hardware expenditures purchased and in service after July 1, 2005 is 3 years straight-line.

Computer software includes development costs related to specific products or processes that are proven to be technically and economically feasible. Depreciation thereof commences at the time of capitalization. All research costs are charged to operations in the period incurred.

Deferred finance charges:

Deferred finance charges relate to the class of Series B Convertible Preferred Shares. Amortization of the deferred finance charges is calculated on a straight-line basis over five years.

(g) Income taxes:

The Company provides for income taxes using the asset and liability method. Under this method current income taxes are recognized for the estimated income taxes payable for the current year and future income taxes are recognized for temporary differences between the tax and accounting bases of assets and liabilities and for the benefit of losses available to be carried forward for tax purposes that are considered more likely than not to be realized. Future income tax assets and liabilities are measured using tax rates expected to apply in the years in which temporary differences are expected to be recovered or settled. Any change to the net future income tax asset or liability is included in operations in the year it occurs. A valuation allowance is recognized against any future income tax assets if it is considered more likely than not that the asset will not be realized.

(h) Diluted per share amounts:

Diluted per share amounts are computed using the "treasury stock" method whereby outstanding stock options and share purchase warrants are only dilutive if the average market price of the common shares exceeds the exercise price of the stock options and share purchase warrants.

(i) Stock-based compensation:

The Company accounts for its "market growth options" as equity instruments awarded to employees, officers and directors and determines compensation expense based on the fair value of the option on the grant date. Compensation expense is recognized over the expected vesting period of the option. A forfeiture rate is factored into the calculation of the fair value option price.

The Company also has phantom options, as described in note 8 (d). Since the phantom options include a cash settlement or equity settlement alternative, stock-based compensation cost is measured at intrinsic value and recognized as an expense over the vesting period. Intrinsic value is the difference between the exercise price of phantom options and the trading price of common shares at the balance sheet date. The Company accounts for cash settled phantom options as liabilities and equity settled phantom options as equity.

The Company recognizes stock-based compensation expense on the shares purchased from treasury, as described in note 12, over the period of shareholder loan.

(j) Cash:

Cash represents highly liquid short term deposits with original maturities of 90 days or less.

2. ECONOMIC DEPENDENCE:

A company controlled by a major shareholder provided the Company with a demand loan of $1,000,000 of which $512,500 was repaid in the second quarter of 2006 by the Company. The major shareholder provided the Company with the financing it requires to support its international expansion, its investment in the development of new technologies and general operations. The Company will continue to rely on this funding and potential future funding until other third party financing becomes available. In addition, the major shareholder holds $3,681,784 of the outstanding preferred shares.

3. PROPERTY AND EQUIPMENT:

December 31, 2006	Cost	Accumulated depreciation	Net book value
Computer hardware			
Acquired up to June 30, 2005	$ 9,580,847	$ 7,918,351	$ 1,662,496
Acquired after June 30, 2005	1,896,095	568,476	1,327,619
Computer software	4,133,266	2,133,195	2,000,071
Equipment and furniture	238,566	97,227	141,339
Leasehold improvements	519,829	133,438	386,391
	$ 16,368,603	$ 10,850,687	$ 5,517,916

December 31, 2005	Cost	Accumulated depreciation	Net book value
Computer hardware			
Acquired up to June 30, 2005	$ 10,324,523	$ 7,579,980	$ 2,744,543
Acquired after June 30, 2005	741,032	59,739	681,293
Computer software	4,594,055	2,281,381	2,312,674
Equipment and furniture	180,545	72,148	108,397
Leasehold improvements	330,671	92,996	237,675
	$ 16,170,826	$ 10,086,244	$ 6,084,582

For the fiscal year ended December 31, 2006, out-of-service computer hardware with a net book value of $120,963 (2005 - $1,250,122) was written off and a corresponding amount has been included in depreciation expense.

Included in computer software are capitalized development cost additions of $834,183 for the year ended December 31, 2006 (2005 - $951,761).

OTHER ASSETS:

	2006	2005
Deferred finance charges	**$ 112,271**	$ 112,271
Accumulated amortization	**95,190**	89,496
Net book value	**$ 17,081**	$ 22,775

Amortization of deferred finance charges is included in interest on the statement of operations.

OME TAXES:

Income tax expense differs from the amount that would be computed by applying the combined Federal and Provincial statutory income tax rate to the loss before income taxes. The reasons for the differences are as follows:

	2006	2005
Earnings (loss) before income taxes	**$ 239,157**	$ (1,017,301)
Combined Federal and Provincial statutory rate	**32.12%**	33.62%
Computed expense (recovery)	**$ 76,817**	$ (342,017)
Increase (decrease) resulting from:		
Non-deductible expenses	**320,054**	269,328
Change in enacted tax rates	**325,302**	–
Adjustment for foreign income tax rate	**100,622**	27,222
Change in valuation allowance	**(498,000)**	2,142,000
Other	**(324,795)**	(296,533)
Actual reduction	**$ –**	$ 1,800,000

The components of the future income tax asset at December 31, 2006 are as follows:

	Canada	All Other	Total
Non-capital/net operating losses	**$ –**	**$ 6,443,000**	**$ 6,443,000**
Capital losses	**4,070,000**	**–**	**4,070,000**
Property and equipment	**1,656,000**	**(132,000)**	**1,524,000**
Other	**967,000**	**–**	**967,000**
	$ 6,693,000	**$ 6,083,000**	**$ 13,004,000**
Less valuation allowance	**6,693,000**	**6,083,000**	**13,004,000**
Future income tax asset	**$ –**	**$ –**	**$ –**

The components of the future income tax asset at December 31, 2005 are as follows:

	Canada	All Other	Total
Non-capital/net operating losses	$ –	$ 6,128,000	$ 6,128,000
Capital losses	4,260,000	–	4,260,000
Property and equipment	2,359,000	(224,000)	2,135,000
Other	979,000	–	979,000
	$ 7,598,000	$ 5,904,000	$ 13,502,000
Less valuation allowance	7,598,000	5,904,000	13,502,000
Future income tax asset	$ –	$ –	$ –

The net operating loss carryforwards reflected above as at December 31, 2006 expire as follows:

United States	Net operating losses
2009	U.S. $ 2,500,000
2010	1,200,000
2011	2,300,000
2019	300,000
2020	2,000,000
2021	830,000
2022	160,000
2023	1,650,000
2024	3,100,000
2025	610,000
	U.S. $ 14,650,000

6. CREDIT FACILITY:

The Company has a demand loan with Video Age Limited, a company controlled by Seymour Epstein, Chairman of the Board and a major shareholder of the Company, in the amount of $487,500 with an annual interest rate of 7.75 percent, which is consistent with prevailing commercial terms. The Company uses this demand loan for general corporate purposes.

In 2006, the balance owing on the demand loan was reduced to $487,500 when 1,250,000 warrants at a price of $0.41 each that were previously issued in June of 2001 to Seyco Operations Ltd., another company controlled by Seymour Epstein, Chairman of the Board and a major shareholder of the Company, were exercised. The total funds received by the Company when the warrants were exercised amounted to $512,500. All of the funds received were used to reduce the balance on the demand loan from $1,000,000 to $487,500.

Interest paid on the capital lease during the years ended December 31, 2006 and 2005 amounted to $42 and $2,493, respectively.

7. PREFERRED SHARES:

In 2005, the Company issued 3,333,333 Series C Convertible Preferred Shares at $0.30 per share. Each Series C Preferred Share is convertible, at the option of the holder, into one common share at any time up to June 30, 2010, the expiry date. The shares are redeemable at the close of business on the next business day following the fifth anniversary of the date of issue. The shares carry a dividend rate of 7.25 percent. The dividends are cumulative. 3,333,333 shares were issued for proceeds of $1,000,000. Preferred shares are recorded at the amount of proceeds received less the amount attributed to the conversion feature of $170,887 which is included as part of shareholders' equity.

In 2004, the Company issued 7,566,508 Series B Convertible Preferred Shares at $0.50 per share. Each Series B Preferred Share is convertible, at the option of the holder, into one common share and a payment of $0.08 at any time up to November 5, 2009, the expiry date. The shares carry a dividend rate of 7.25 percent and under certain conditions the Company will have the right to make the $0.08 payment on conversion in the form of common shares. The dividends are cumulative. As previously mentioned, preferred shares are recorded at the amount of proceeds received less the amount attributed to the conversion feature of $641,819 which is included as part of shareholders' equity. Given that the shares are convertible at the option of the holder any time prior to expiry the $0.08 payment amount per share amount has been classified as a current liability.

The Company, with agreement from all of the Preferred Shareholders affected, issued demand promissory notes for the dividends that were accrued but not paid on September 30, 2005 and December 31, 2005. The total amount of the promissory notes issued was $168,332. Interest on the demand promissory notes is payable quarterly at a rate of 7.25 percent per annum, with interest on overdue amounts at the same rate. On January 24, 2006 the promissory notes were repaid in full.

Cash dividends of $406,822 were paid in 2006 (2005 - $137,770) on the class of Series B Convertible Preferred Shares. Cash dividends of $108,134 were paid in 2006 (2005 - $nil) on the class of Series C Convertible Shares. Dividends have been included in interest expense in the statements of operations.

SHARE CAPITAL:

(a) Authorized:

Unlimited number of Common Shares

Unlimited number of Senior Preferred Shares, the rights, privileges, restrictions and conditions attached to each series thereof to be determined by the Board of Directors prior to issuance.

Unlimited number of Junior Preferred Shares, the rights, privileges, restrictions and conditions attached to each series thereof to be determined by the Board of Directors prior to issuance.

	Number of Common Shares 2006	**Amount 2006**	Number of Common Shares 2005	Amount 2005
Balance, December 31	**40,373,441**	**$ 12,842,580**	39,569,721	$ 12,609,071
Issued on exercise of warrants	**1,250,000**	**512,500**	–	–
Issued on exercise of options	**11,765**	**–**	13,131	–
Issued (note 12)	**–**	**–**	790,589	232,600
Stock-based compensation	**–**	**2,845**	–	909
Balance, December 31	**41,635,206**	**13,357,925**	40,373,441	12,842,580
Shareholder loan (note 12)	**–**	**(232,600)**	–	(232,600)
Balance, December 31	**41,635,206**	**$ 13,125,325**	40,373,441	$ 12,609,980

The Company has a share option plan under which employees, officers and directors are eligible to receive options to acquire Common Shares, subject to a limit of 6.8 million shares. The options vest immediately or up to a period of either 3 or 4 years with expiry terms of 4 years. At December 31, 2006 the number of options outstanding was 2,305,000 at prices ranging from $0.40 to $0.64 per share and expiring on various dates to May 24, 2010.

Changes in options are summarized as follows:

	2006		2005	
	Number of options	**Weighted average exercise price**	Number of options	Weighted average exercise price
Outstanding, beginning of year	**1,604,654**	**$ 0.55**	3,097,301	$ 0.54
Granted	**1,880,000**	**0.43**	525,000	0.45
Exercised	**(45,000)**	**0.34**	(65,000)	0.32
Cancelled	**(1,134,654)**	**0.58**	(1,952,647)	0.51
Outstanding, end of year	**2,305,000**	**$ 0.44**	1,604,654	$ 0.55
Exercisable, end of year	**281,652**	**$ 0.48**	1,017,978	$ 0.60

The following table summarizes information regarding the options outstanding at December 31, 2006:

	Options outstanding			Options exercisable	
Range of exercise prices	Weighted average remaining life	Number	Weighted average exercise price	Number	Weighted average exercise price
$0.40 to $0.50	33 months	2,245,000	$ 0.44	226,652	$ 0.45
$0.51 to $0.64	6 months	60,000	$ 0.60	55,000	$ 0.61
$0.40 to $0.64	32 months	2,305,000	$ 0.44	281,652	$ 0.48

All of the 2,305,000 options outstanding are in the form of "market growth options" whereby the option holder makes no payment to the Company but instead receives a reduced number of Common Shares, calculated in relation to the difference between the current market price of the shares and the exercise price thereof. During 2006, 45,000 options (2005 – 65,000) were converted into 11,765 common shares (2005 – 13,131).

The weighted average fair value of stock options granted during the year was $0.25 (2005 - $0.20) on the grant date using the Black-Scholes option pricing model with the following weighted assumptions: risk-free interest rate of 4.01 percent (2005 – 3.06) percent), expected life of four years, expected volatility of 70 percent (2005 – 60 percent), and no expected dividend. The Company recognized compensation expense of $192,889 (2005 - $145,645) for stock-based employee compensation awards with a corresponding recognition of contributed surplus during 2006.

(d) Phantom options:

In 2006, the Company issued 455,000 phantom options to new employees as an inducement to accept the Company's offer of employment. In addition, the Company issued phantom options to employees as an incentive to accept job promotions. These phantom options have a four-year term and will vest one third after one year and a further one third at each of the next two anniversaries of the date of acceptance of employment. Upon exercise the employee will receive, in cash, the difference between the phantom price and the price of the shares of the Company on the Toronto Stock Exchange on the date of such exercise. These phantom options have exercise prices ranging from $0.27 to $0.39. The Company recorded compensation expense in 2006 of $300 on these phantom options.

In 2005, as an inducement to accept the Company's offer of employment the President and CEO received 1,000,000 phantom options. The phantom options are priced at $0.30. These phantom options have a six-year term and will vest 200,000 after one year and a further 200,000 at each of the next four anniversaries of the date of acceptance of the offer of employment. Upon exercise of each vested phantom option the President and CEO will receive, at the option of the Company, either cash or common shares of equivalent value in an amount equal to the difference between the initial price of the phantom options and the exercise price. The exercise price will be the closing price of the shares of the Company

on the TSX for the trading date immediately preceding the date the Company receives notification to exercise the vested phantom options. The Company records compensation expense based on the difference between the market value of the stock and the price of the option. The Company recorded negative compensation expense in 2006 of $15,200 (2005 – expense of $15,200) on these phantom options.

At December 31, 2006, the total number of phantom options outstanding was 1,455,000 at prices ranging from $0.27 to $0.39 per share and expiring on various dates to June 12, 2012. Changes in phantom options are summarized as follows:

	2006		2005	
	Number of options	**Weighted average exercise price**	Number of options	Weighted average exercise price
Outstanding, beginning of year	**1,000,000**	**$ 0.30**	–	$ –
Granted	**455,000**	**0.34**	1,000,000	0.30
Outstanding, end of year	**1,455,000**	**$ 0.31**	1,000,000	$ 0.30
Exercisable, end of year	**200,000**	**$ 0.30**	–	$ –

The following table summarizes information regarding the phantom options outstanding at December 31, 2006:

	Phantom Options outstanding			Options exercisable	
Range of exercise prices	Weighted average remaining life	Number	Weighted average exercise price	Number	Weighted average exercise price
$0.27 to $0.39	53 months	1,455,000	$0.31	200,000	$0.30

Contributed surplus:

	2006	2005
Opening balance, January 1	**$ 561,314**	$ 416,578
Stock-based compensation	**241,043**	145,645
Conversion of options	**(2,845)**	(909)
Closing balance, December 31	**$ 799,512**	$ 561,314

Warrants:

In 2006, all of the 1,250,000 warrants outstanding as at December 31, 2005 that were issued in June 2001 to a major shareholder to acquire 1,250,000 Common Shares at a price of $0.41 were exercised prior to expiry. The Company received proceeds of $512,500 when the warrants were exercised.

Per share information:

The following table summarizes the common shares used in calculating net income (loss) per common share:

	2006	2005
Weighted average number of common shares outstanding – basic and diluted	**40,326,275**	39,570,284

For the year ended December 31, 2006, a total of 2,305,000 employee stock options (2005 – 1,604,654), 1,000,000 phantom options (2005 – 1,000,000), 790,589 shares from treasury (2005 – 790,589) for the share purchase loan, 7,566,508 Series C Convertible Preferred Shares (2005 – 7,566,508) and 3,333,333 Series B Convertible Preferred Shares (2005 – 3,333,333) were not included in the calculation of dilutive potential common shares as the result would be anti-dilutive.

9. COMMITMENTS:

Future minimum payments relating to operating leases are as follows:

2007	$ 1,601,268
2008	1,423,471
2009	1,393,988
2010	1,322,106
2011	–

The majority of the future minimum payments relating to operating leases is for office space. In addition, the Company has operating leases for office equipment and computer hardware both of which will expire in 2007.

10. FINANCIAL INSTRUMENTS:

(a) Interest rate risk:

The Company is not exposed to interest rate fluctuations.

(b) Foreign currency risk:

The Company is exposed to foreign currency fluctuations in respect of its operations in the United States, United Kingdom and Libya.

The Company recorded a net foreign currency gain for the year ended December 31, 2006 of $70,222 and a net foreign currency loss for the year ended December 31, 2005 of $16,945. The Company did not enter into any forward exchange contracts in 2006.

(c) Credit risk:

The Company's revenue is largely derived from well-established customers such that credit risk is not considered significant. As at December 31, 2006 one client had an outstanding balance of approximately 11 percent of total accounts receivable (2005 – 14 percent).

(d) Fair values:

The fair values of all monetary assets and liabilities at December 31, 2006 approximate their book values due to their short-term to maturity. In addition, the fair values of all preferred shares and fixed rate debt at December 31, 2006 approximate their book values.

11. RELATED PARTY TRANSACTIONS:

The majority of the Series B and Series C Convertible Preferred Shares are held by a company related to the Company's major shareholder and a director, another director and three officers of the Company. Dividends paid in this regard for the Series B and Series C Convertible Preferred Shares in 2006 were $501,340 (2005 - $129,636).

12. SHARE PURCHASE LOAN:

On July 5, 2005, the President and CEO, as an inducement in his employment contract, received an interest free demand loan in the amount of US $200,000 for a period of 3 years, which was used to purchase 790,589 shares from treasury of the Company. Each share was priced at $0.30 Canadian. The Company can make a demand for payment of the loan at any time and following such demand the loan or any unpaid balance of the loan shall earn interest at the lower of the Company's cost of borrowed funds during each month that the loan remains unpaid plus three percent and the highest legal rate of interest chargeable in the State of Texas. The share purchase loan receivable for this transaction is presented as a deduction from shareholders' equity and as such has not been treated as outstanding for purposes of calculating basic earnings per share, as previously mentioned. In 2006, the Company recorded stock-based compensation expense in the amount of $47,854 (2005 - $nil) on the shares. The market value of these common shares as at December 31, 2006 was $229,271 (2005 - $292,518). The Company holds the shares as collateral for the loan.

13. SEGMENTED INFORMATION:

Based on the Company's internal management reporting structure, operating segments have been established for (a) Seismic Data Processing - reflecting the processing of customers' seismic data - and (b) Data Management - reflecting the storage of seismic and other customer data, in electronic and hard copy formats, with on-line access capabilities. The point of origin of revenues and the location of assets determine the geographic areas.

Industry information:

December 31, 2006	**Seismic Data Processing**	**Data Management**	**Total**
Revenue	**$ 19,327,942**	**$ 6,583,206**	**$ 25,911,148**
Operating expenses	**16,639,373**	**5,318,710**	**21,958,083**
Depreciation and amortization	**2,582,131**	**607,575**	**3,189,706**
Foreign exchange gain	**(60,430)**	**(9,792)**	**(70,222)**
Segment earnings	**$ 166,868**	**$ 666,713**	**$ 833,581**
Interest			**594,424**
Earnings before income taxes			**239,157**
Expenditures on property and equipment	**$ 2,203,304**	**$ 422,826**	**$ 2,626,130**
Total assets	**$ 11,867,184**	**$ 3,625,516**	**$ 15,492,700**

December 31, 2005	Seismic Data Processing	Data Management	Total
Revenue	$ 17,783,052	$ 6,081,985	$ 23,865,037
Operating expenses	15,263,613	4,813,440	20,077,053
Depreciation and amortization	3,191,990	1,004,475	4,196,465
Foreign exchange loss	16,400	545	16,945
Segment earnings (loss)	$ (688,951)	$ 263,525	$ (425,426)
Interest			591,875
Loss before income taxes			(1,017,301)
Expenditures on property and equipment	$ 2,330,445	$ 436,045	$ 2,766,490
Total assets	$ 11,517,396	$ 4,216,286	$ 15,733,682

Geographic information:

December 31, 2006	**Canada**	**All Other**	**Total**
Revenue	**$ 15,678,220**	**$ 10,232,928**	**$ 25,911,148**
Property and equipment	**3,102,771**	**2,415,145**	**5,517,916**

December 31, 2005	Canada	All Other	Total
Revenue	$ 15,915,980	$ 7,949,057	$ 23,865,037
Property and equipment	3,370,643	2,713,939	6,084,582

The Company has seismic processing operations in the United Kingdom and Libya. In 2006, the revenue generated in these locations was immaterial and is classified under "All Other" the majority of which relates to the Company's US-based operations. In addition, property and equipment in these locations is immaterial and has also been classified under "All Other" the majority of which also relates to the Company's US-based operations.

During 2006 the Company generated 13 percent (2005 – 11 percent) of its revenue from a single customer.

14. COMPARATIVE FIGURES:

Certain comparative figures with respect to fiscal 2005 have been reclassified to conform with the current year's presentation.

Corporate Information

Board of Directors
Seymour Epstein [3,4]
Chairman and CEO,
Epstein Enterprises Inc.

Francis P. McGuire [1]
President and CEO,
Major Drilling Group
International Inc.

Oded O. Levi [2]*
Senior V-P and CFO
Epstein Enterprises Inc.

Victor Peters [1,3,4]
Lawyer and Businessman

Rene VandenBrand
President and CEO
Kelman Technologies Inc.

Michael R. Van Every [1,2,4]
Corporate Director

Paul D. Watson [2,3]
Vice-President, Exploration
Watch Resources Ltd.

[1] Member of the Audit Committee
[2] Member of the Compensation Committee
[3] Member of the Corporate Governance Committee
[4] Member of the Tax Committee
* Effective November 14, 2006

Officers
Seymour Epstein
Chairman of the Board

Rene VandenBrand
President and CEO

Steve Darnell
Senior Vice-President,
Data Management

Neil S. Baker
Vice-President,
Data Management

Debbie L. Garbutt
Vice-President, Controller
and CFO

Doug Kuervers
Vice-President, North American
Seismic Processing

Brian H. Link
President, KT International

Patrick J. McKenny
Vice-President, Canadian Sales
and Marketing

John A. Paul
Vice-President, Administration
and Corporate Secretary

Vivian R. Martin
Assistant Secretary

Registrar and Transfer Agent
CIBC Mellon Trust Company
Calgary, Alberta

Auditors
KPMG LLP
Calgary, Alberta

Legal Counsel
Fraser Milner Casgrain
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